Joint Legislative Committee on Local Government

February 13th, 2012

Name: Jack Horton

Title: County Manager

County: Macon

Ladies and Gentlemen,

Thank you for the opportunity to speak to you today concerning Local Government Debt and Financing. I have over 35 years experience in local government in North Carolina, having started my career in Swain County in 1976. I am currently serving as County Manager in Macon County, and I previously served as County Manager in Caldwell, Haywood, and Macon Counties as well as Town Manager of Huntersville. Over the course of my career I have been involved in numerous capital projects that required debt service. These include water and sewer infrastructure, Landfills and Solid Waste Facilities, Schools, Jails, Courthouses, Libraries, and various other capital building projects and equipment purchases. Although the financing of these projects share some common characteristics, each project has its own unique circumstances as well.

Local governments in North Carolina are fortunate to have at our disposal several critical and important resources when it comes to public finance and being good stewards of the public trust. I am grateful for the staff and leadership of our Local Government Commission through the State Treasurer's Office, the North Carolina School of Government, our North Carolina Association of County Commissioners, and the League of Municipalities. These resources help make our state a leader in local government management and financial integrity. My comments today will follow a format of topics I understand the committee is interested in knowing more about. My comments will closely follow what we have done and are doing in Macon County.

How are capital projects selected for financing?

Local governments that develop long and short range capital improvement plans generally do so by developing a Capital Improvements Plan. The plan is developed by staff and reviewed, and or modified by the Governing Board prior to budget development. Before you get to the point of issuing debt for a particular project, the local government should and in many cases considers the following:

- Will this project put the county in compliance with state laws or regulations?
- Is it a legal mandate?
- It is better to renovate or replace?
- What will be the impact on the annual budget (tax rate, etc.)

- Will this project save money or cost money over time?
- How will this affect county services?
- Is there a public health or safety issue involved?
- Will the project compliment our Economic Development efforts, and raise the standard of living for our citizens?
- Will it improve the quality of life here?
- What funding sources are available?
- How reliable are these sources?
- How will the project impact the county debt capacity?
- Will funding and construction correspond given the time table?
- What is the long term benefit to the community?
- What are the consequences if the project is not approved?

Macon County had a capital improvements plan initiative that was developed and put before the public in 2007. The plan was without a doubt very ambitious involving a series of General Obligation Bonds totaling $64,000,000. It included $42,100,000 for Public School Improvements, $6,500,000 for building improvements for Social Services, Senior Services, and Emergency Services, $3,000,000 for Community College Improvements, $9,400,000 for Parks and Recreation Facilities, and $3,000,000 for Library Facilities. The Bond Referendum failed, but the needs did not go away. A new approach had to be developed to meet the need. That referendum also included a way to pay the debt service. The unpopular land transfer tax. Needless to say that failed as well. The challenge was how can we provide these vital facilities and maintain a property tax rate a reasonable level? In Macon County we found a way , and over the last four years the county has been able to provide by various approved financing methods over $40,000,000 for Public School Improvements and still maintains the lowest county property tax rate in the state at 27.9 cents per hundred.

Macon County Public School Capital Funding

Capital improvements to East Franklin Elementary School (QZAB)	$2,000,000
New Intermediate School and expansion to East Franklin Elm.	$19,121,101
Purchase (Owens) property for Mountain View Intermediate	$2,600,000
Nantahala Renovation (QZAB)	$1,800,000
Iotla Valley Elementary School Construction (QSCB)	$13,869,000
Franklin High School Improvements	$1,321,000
Highlands School Improvements and sports fields	$ 938,000
Macon County Early College	$878,899
Total County Funded School Capital Projects since 2008	**$42,528,000**

In addition to the schools facility improvements, the county has been able to construct a new Animal Shelter, a Solid Waste Transfer Station, is on the verge of completing a $5,500,000 sewer project, a $2,000,000 water project, renovated an old Library into a Senior Services Center/Community Resource Center, and renovated and expanded a new Emergency Medical Services Facility. Again while maintaining a low stable property tax rate. The public has been kept aware of the progress the county has made in these challenging times and has in many cases been complimentary of the county's efforts on behalf of our children, seniors, and Public Safety.

How is a Financing Method determined?

Once a project is identified, a determination is made as to the best alternative for the county. Things to consider are timeliness, issuance cost, interest rate, and long term cost. Often it not simply the selection of a method of financing and proceeding with the project, it may be the case that based on our local situation what methods are available, realistic and attainable. This may in fact limit your options. **Case in point: Iotla Valley Elementary School,** the project started during times of economic prosperity, and voter approval was sought for a General Obligation Bond. The referendum failed, the economy tanked, and the project was put on indefinite hold. The need was still there, the tax burden was an important consideration, and things were likely to get worse before they got better. After months of review and discussion the Governing Body determined that if the county could limit the debt service payment to no more that a cent and a half on the tax rate they would consider moving ahead with the project. The staff researched alternatives and found that the USDA had a program for low interest loans and extended repayment options that would allow the county to finance the project with a small tax increase (1.5cents). We met with the staff of the Local Government Commission for advice and direction and proceeded with design development of the project. Along the way we became aware of additional availability of QSCB funds from the American Recovery and Reinvestment Act. We applied and were awarded the necessary approval to use this source to help repay the debt on the new school. As a result we dropped the USDA route and proceeded with the traditional financing with Federal reimbursement which dropped our net interest rate to .48% and a 17 year payout. This coupled with the fact that construction cost were at an all-time low gave the county a new 94,000,000 square foot elementary school at cost of $118.00 per foot. In this case we looked at General Obligation Bonds, Installment Purchase Contracts, Certificates of Participation, and Federally Subsidized financing. The first consideration on which financing method to use should be discussed in depth with the Local Government Commission before any decision is made.

What level of review is undertaken at the county level before submission to the LGC?

Before a jurisdiction seriously considers a project that requires financing, it needs to determine the size, scope, and probable cost of the project. The first stop in the process no matter how financing will be accomplished is a visit with the staff of the Local Government Commission. Expect to get straight talk on options and a clear indication on your unit's financial management performance and its ability to handle the debt obligation. Base on you meeting with LGC you are instructed on the necessary steps that have to happen before final LGC approval is given.

I find that the following guidelines on debt issuance to be very helpful:

Guidelines on Debt Issuance

State of North Carolina Department of State Treasurer

In an effort to assist applicants in receiving timely approval of financing requests by **the Local Government Commission (LGC),** the staff has prepared these guidelines and suggestions. These are intended to indicate steps applicants may take to expedite approval and to point out pitfalls that may delay or complicate the approval process and are to be avoided. The items are divided into two broad categories, Fiscal Management and Debt Management and the Project, and are generally related to the statutory findings required of the LGC.

A. Fiscal Management

1) Adequate and timely responses to issues raised in a unit letter sent by the Fiscal Management Section must have been received. All concerns regarding the financial management of the unit must be resolved, such as a low General Fund balance (Below 8%), a low tax collection rate (Below 90%), receipt of a qualified audit opinion, habitual violations of "The Local Government Budget and Fiscal Control Act", inadequate internal controls, weakness in an enterprise fund or an enterprise fund that is not self-supporting, and similar concerns.

2) A budget for the unit must be adopted prior to the beginning of its fiscal year.

3) Current audited financial statements must be available on a timely basis. For units of local government, this would mean that the audited financial statements have been received by October 31. For units with a calendar year or fiscal year not ending on June 30, audited financial statements should be received within four months of year-end. Financing applications for LGC approvals after October 31 will require the audited financial statements of the immediately preceding fiscal year, and the audited statements should be submitted at least two weeks prior to the LGC meeting date to allow adequate time for staff review.

4) If a Power Agency unit is involved, it must comply with the policy approved by the governing body of the unit regarding transfers from the electric system to the General Fund.

B. Debt Management and the Project

1) Make a point to discuss the unit's capital improvement plans with the LGC staff as they are being developed. Follow-up visits are encouraged when major changes occur.

2) The staff of the LGC should be contacted very early in the planning stage regarding the proposed debt issuance. This early contact is necessary to make sure the process gets off to

a good start. Having to “back up and restart” can significantly delay the process. This is especially important if an innovative financing is contemplated which may require consideration of unusual covenants, special justification of necessity or cost, private activity usage, special Interlocal agreements, unusual amortization schedules, and other innovations.

3) The unit should have a reasonable debt burden. A heavy debt burden may be evidenced by a ratio of General Fund Debt Service to General Fund Expenditures exceeding 15%, or Debt per Capita or Debt to Appraised Property Value exceeding that of similar units. (See Local Government Commission “Analysis of Debt”)

4) The request to borrow must be for capital expenditures, not operating expenses.

5) The project must be “ready”. Construction bids, required major permits and Phase I Environmental Studies should be received before the approval or, at the latest, before the sale of the debt. Other required sources of funding must be committed.

6) Any threat or existence of litigation related to the project or the financing must be satisfactorily resolved. Litigation could affect either the marketability of the debt or the borrower’s ability to repay the debt.

7) Community support for the project is important, especially for non-voted debt. Lack of community support may be evidenced by comments at meetings of the governing body or public hearings, correspondence, newspaper articles, etc.

8) The repayment plan presented must be complete and consistent regarding the maturity of debt, life of assets financed, terms of related agreements, etc. In addition, the repayment plan must be consistent with the financial projections provided by the issuer. Amortization of principal should be level for all general fund projects. Use level principal and interest payments for an enterprise fund may be appropriate.

9) Financial projections should be presented that demonstrate feasibility and are clearly reasonable in comparison to prior financial performance. Appraisals, feasibility studies and comfort letters (if required) must be prepared by parties that are both independent to the transaction and possessing adequate expertise.

10) There should be no outstanding concerns or unresolved matters relating to a prior bond issue, such as incomplete or late filing of rebate reports, failure to meet continuing disclosure obligations, violations of covenants in other obligations, or other matters of concern. Such unresolved matters may prevent or delay the issuance of future debt.

11) Documentation must be provided showing that covenants in outstanding obligations will be satisfied if the proposed debt is issued, i.e. additional debt tests, restrictive covenants regarding additional debt, etc.

12) The ability to secure an investment grade rating should be documented. Enhancements including letters of credit, bond insurance, a parent guarantee, etc. should be considered.

13) A complete application must be filed four weeks prior to the LGC meeting date (first

Tuesday of every month) including documentation of all required resolutions being adopted by the governing body. This provides adequate time for staff review of the application and for compiling any additional information that may be necessary.

14) Bond or loan documents must be in substantially final form before presentation at the LGC meeting.

15) If a refunding is contemplated, the present value of the savings should exceed 3% of the refunded bonds. Generally, the term of the original debt should not be extended when bonds are refunded.

16) The sale date should be requested as early as practical. This provides some flexibility in selection of a date that should not compete with another previously scheduled sale or a bond market holiday. This assures that the most favorable interest rate is obtained for each issuer of debt.

Measures that are used locally to determine debt affordability and risk

As mentioned earlier we depend considerably on the LGC to be our watchdog as to affordability and risk. I can honestly say that they have never given me or my jurisdiction bad advice when it comes to financing capital projects. It goes without saying if you seek good advice do not be so disregard the effort. In terms of local measures for affordability the key element is what effect will it have on the property tax rate. If the project has overwhelming support, the public and the Governing Body are more likely to accept an increase in taxes and can probably justify the affordability of the measure. It must be considered not as a standalone project but how it contributes to the overall debt obligation on the unit of government. A calculation of income to debt ratio is always advisable. The risk factor is a very important consideration on the local level as well. While there is no absolute risk free project, steps must be taken to ensure that revenues will be there to retire the debt. The best risk is the full faith and credit of the taxing authority of the unit of government, but many times other revenue sources are identified in satisfying the obligation. Recent issues about the continued availability of ADM funding and Lottery proceeds may lead many on the local level to not rely on these funds to help offset set in school related projects.

Public Involvement in the Process

In addition to regular public input session at County Commission meetings the county schedules public hearings on proposed financing arrangements as required by NCGS 160A (G)

(g) Public Hearing. Before entering into a contract under this section involving real property, a unit of local government shall hold a public hearing on the contract. A notice of the public hearing shall be published once at least 10 days before the date fixed for the hearing.

Macon County is widely covered by the media (5 local newspapers, the local radio station and an independent blogger). When a project requiring financing approval by the Board of Commissioners is required, we make every effort to notify the public, by notices in the local newspaper, on the county web site, and the local radio station. Often several public hearings are required concerning a particular project. This is all detailed in requirements from the state as well as lending institutions. In most cases there is considerable debate as to the justification for a particular project, outlining the benefits and cost to the taxpayers. I would well imagine that there are very few capital improvement projects that attract the support of 100% of the citizens. This is to be expected. Public input is critical and expected. Unless your financing involves a public referendum (bond vote) , the only other viable option for public input is the public hearing. If a unit of local government does not comply with all the requirements for the public hearing, the projects will receive neither the approval of the LGC or the lending institution.